Understanding what goes in to the FTSE100

The latest quarterly review of the FTSE 100 revealed common misunderstandings about how the index is drawn up.

Every quarter FTSE Russell, which operates all the FTSE indices, decides which companies are promoted or demoted from the FTSE 100 index.

There had been speculation that the June review would see Marks & Spencer (M&S) replaced by Ocado. The high street chain has been a member of the Footsie since the index first appeared in 1984, so for the bricks and mortar shopping experience to be supplanted by an online-only retailer that did not arrive on the stock market until 2010 made for a good headline.

However, M&S did not check out of the FTSE100 and survives until the next quarterly review. What the journalists missed is that a company listed in the FTSE 100 is only ejected if its ranking drops below 110. Similarly, promotion into the FTSE100 requires a ranking of 90 or higher.

These rules are designed to avoid a large quarterly churn at the bottom tier of the index, and it works – only one other company, GVC Holdings, entered the index in June.

GVC is gaming company, based in the Isle of Man and listed in London. The main reason it entered the FTSE100 was that it took over a more familiar betting name, Ladbrokes Coral. To do so, GVC issued more shares and thus increased its all-important market capitalisation.

June's changes to the FTSE100 remind us that the construction and operation of stock market indices are not as simple as might be imagined. Whether you are considering investing in an index tracker fund or comparing fund performance against an index, it is a point to remember.

The value of your investment can go down as well as up and you may not get back the full amount you invested.

Past performance is not a reliable indicator of future performance.

Investing in shares should be regarded as a long-term investment and should fit in with your overall attitude to risk and financial circumstances.